

# **M**ANAGEMENT'S DISCUSSION AND ANALYSIS

This section of the City of Scottsdale's (the City) Comprehensive Annual Financial Report presents a narrative overview and comparative analysis of the financial activities of the City for the fiscal years ended June 30, 2005 and 2004. We encourage readers to consider the information presented here in conjunction with additional information that we have furnished in our letter of transmittal and the basic financial statements.

## **FINANCIAL HIGHLIGHTS**

Key Financial highlights for fiscal year 2005 are as follows:

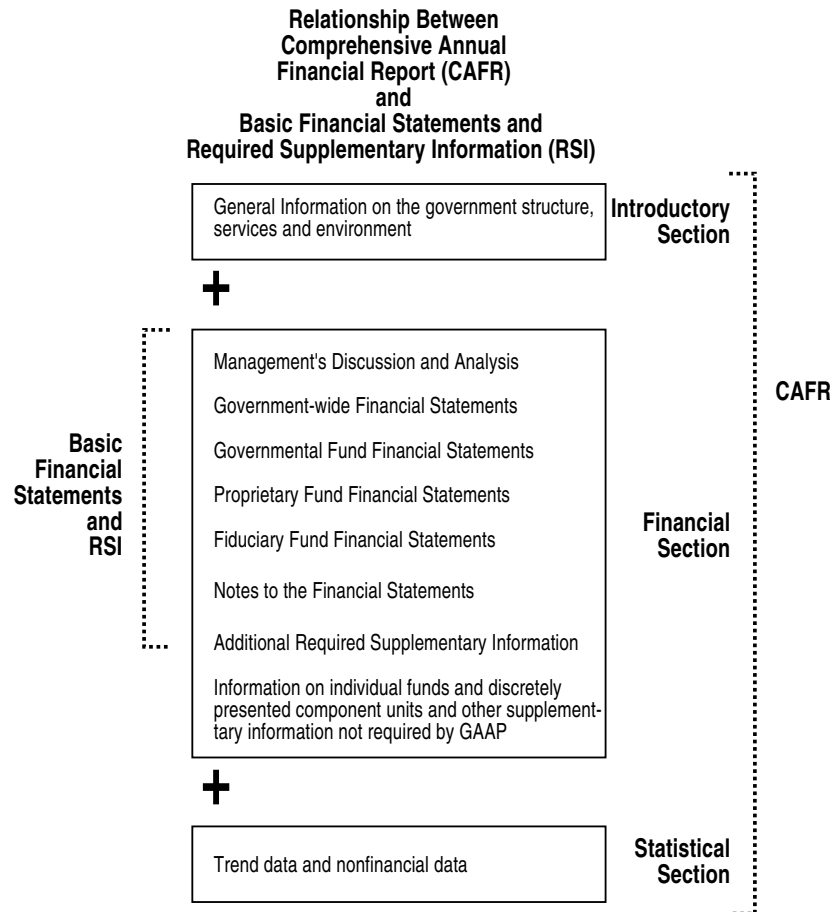
- The assets of the City exceeded its liabilities at the close of the fiscal years 2005 and 2004 by \$2.9 billion and \$2.8 billion (net assets), respectively. Of these amounts, \$430.8 million and \$399.4 million (unrestricted net assets), respectively, may be used to meet the government's ongoing obligations to citizens and creditors.
- The City's total net assets increased by \$119.3 million and \$179.3 million during fiscal years 2005 and 2004, respectively.
- As of June 30, 2005 and 2004, the City's governmental funds reported combined ending fund balances of \$264.8 million and \$317.5 million, respectively. The decrease is primarily due to significant land purchases during fiscal year 2005. Approximately 95.7 percent of the fund balance at June 30, 2005, \$253.3 million, is unreserved fund balance available for spending at the government's discretion, compared to \$306.3 million at June 30, 2004. However, in fiscal year 2005 management has designated \$29.9 million of the unreserved fund balance for various uses and \$148.6 million is for capital projects.
- At the close of the current fiscal year, unreserved fund balance for the General Fund was \$72.8 million or 38.6 percent of total General Fund expenditures of \$188.4 million. At the close of fiscal year 2004, unreserved fund balance for the General Fund was \$59.7 million or 34.3 percent of total General Fund expenditures of \$174.2 million.
- During fiscal years 2005 and 2004, the City's total bonded debt increased by approximately \$27.0 million and \$111.6 million, respectively. Although the City reduced several bond payable balances, the key contributors to the increase were the issuance of new Municipal Property Corporation bonds in the amount of \$60.7 million and Certificates of Participation in the amount of \$7.7 million during fiscal year 2005.

## OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the City's basic financial statements. The City's basic financial statements comprise three components:

- (1) **Government-wide** financial statements,
- (2) **Fund** financial statements, and
- (3) **Notes** to the financial statements.

This report also contains other **supplementary information** in addition to the basic financial statements themselves.



## Government-wide Financial Statements

The **government-wide** financial statements are designed to provide readers with a broad overview of the City's finances, in a manner similar to a private-sector business.

The **statement of net assets** and the **statement of activities** provide information about the whole City, presenting both an aggregate view of the City's finances and a longer-term view of those assets. Major fund financial statements provide the next level of detail. For governmental funds, these statements reflect how services were financed in the short term as well as what dollars remain for future spending. The fund financial statement also displays the City's most significant funds with all other major funds presented in total in one column.

The **statement of net assets** presents information on all of the City's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether or not the financial position of the City is improving or deteriorating.

The **statement of activities** presents information showing how the City's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods, such as revenues pertaining to uncollected taxes and expenses pertaining to earned but unused vacation and sick leave.

Both of the government-wide financial statements distinguish functions of the City that are principally supported by taxes and intergovernmental revenues (governmental activities) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (business-type activities). The governmental activities of the City include general government, police, financial services, transportation, community services, information systems, planning and development, fire, municipal services, citizen and neighborhood resources, human resources and economic vitality. The business-type activities of the City include water, sewer, solid waste, and airport operations.

The government-wide financial statements are for the City itself. However, included within the governmental activities of the government-wide financial statements are the operations of the City of Scottsdale Municipal Property Corporation (MPC), the Scottsdale Preserve Authority (SPA), and the Scottsdale Mountain, McDowell Mountain Ranch, DC Ranch, and Via Linda Road Community Facilities Districts. Although legally separate from the City, these component units are blended with the primary government because of their governance or financial relationships to the City.

Separate financial statements of the MPC, SPA and the Scottsdale Mountain, McDowell Mountain Ranch, DC Ranch, and Via Linda Road Community Facilities Districts may be obtained at the City's Financial Services Department, Accounting Division, 7447 East Indian School Road, Suite 210, Scottsdale, Arizona 85251.

The government-wide financial statements can be found on pages 30 and 31 of this report.

## **Fund Financial Statements**

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The City, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the City can be divided into the following three categories: **Governmental Funds**, **Proprietary Funds**, and **Fiduciary Funds**.

### **Governmental Funds**

Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spendable resources as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in determining what financial resources are available in the near future to finance the City's programs.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

The City maintains several individual governmental funds organized according to their type (special revenue, debt service, and capital projects). Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balances for the General Fund, General Obligation Bond Debt Service Fund, General Capital Improvement Plan (CIP) Construction Capital Projects Fund and the Preserve Privilege Tax Capital Project Fund which are considered to be major funds. Data from the remaining governmental funds are

combined into a single, aggregated presentation. Individual fund data for each of the non-major governmental funds is provided in the form of combining statements in a separate section of this report.

The basic governmental fund financial statements begin on page 32 of this report.

#### **Proprietary Funds**

Proprietary Funds are generally used to account for services for which the City charges customers—either outside customers, or internal units or departments of the City. Proprietary Funds provide the same type of information as shown in the government-wide financial statements, only in more detail. The City maintains the following two types of Proprietary Funds:

**Enterprise Funds** are used to report the same functions presented as business-type activities in the government-wide financial statements. The City uses Enterprise Funds to account for the operations of the Water, Sewer, Solid Waste and Airport operations of the City. All Enterprise Funds are considered to be major funds of the City.

**Internal Service Funds** are used to report activities that provide supplies and services for certain City programs and activities. The City uses Internal Service Funds to account for its fleet of vehicles and self-insurance. Because these services predominantly benefit governmental rather than business-type functions, they have been included within governmental activities in the government-wide financial statements. The Internal Service Funds are combined into a single, aggregated presentation in the Proprietary Fund financial statements. Individual fund data for the Internal Service Funds is provided in the form of combining statements in a separate section of this report.

The basic Proprietary Fund financial statements begin on page 40 of this report.

#### **Fiduciary Funds**

Fiduciary Funds are used to account for resources held for the benefit of parties outside the City. The City has two private-purpose trust funds and two agency funds, which are reported under the Fiduciary Funds. Fiduciary Funds are not reflected in the government-wide financial statement because the resources of those funds are not available to support the City's own

programs. The accounting used for Fiduciary Funds is much like that used for Proprietary Funds.

The basic Fiduciary Fund financial statements begin on page 45 of this report.

#### **Notes to the Financial Statements**

The notes to the financial statements provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes can be found beginning on page 47 of this report.

#### **Required Supplementary Information**

In addition to the basic financial statements and accompanying notes, this report presents certain required supplementary information concerning the City's progress in funding its obligation to provide pension benefits to its employees. This information can be found on page 85 of this report.

#### **Combining Statements**

The combining statements referred to earlier in connection with non-major Governmental Funds, Internal Service Funds, and Fiduciary Funds are presented immediately following the required supplementary information on pensions.

#### **GOVERNMENT-WIDE FINANCIAL ANALYSIS**

While this document contains information about the funds used by the City to provide services to our citizens, the Statement of Net Assets and the Statement of Activities serve to provide an answer to the question of how the City, as a whole, did financially throughout the year. These statements include all assets and liabilities using the accrual basis of accounting similar to the accounting used by the private sector. The basis for this accounting takes into account all of the current year's revenues and expenses regardless of when the cash is received or paid.

These two statements report the City's net assets and the changes in those assets. The change in assets is important because it tells the reader whether the financial position of the City as a

whole has improved or diminished. However, in evaluating the overall position of the City, non-financial information such as changes in the City's tax base and the condition of the City's capital assets will also need to be evaluated.

### Analysis of Net Assets

As noted earlier, net assets may serve as a useful indicator of a government's financial position. For the City, assets exceeded liabilities by \$2.9 billion and \$2.8 billion at the close of the fiscal years 2005 and 2004, respectively.

#### Net Assets

For the Years Ended June 30, 2005 and 2004 (in thousands of dollars)

	Governmental Activities		Business-Type Activities		Total	
	2005	2004	2005	2004	2005	2004
<b>Assets</b>						
Current and Other Assets	\$ 415,801	\$ 436,905	\$ 282,528	\$ 324,954	\$ 698,329	\$ 761,859
Capital Assets	2,237,825	2,090,682	912,642	820,530	3,150,467	2,911,212
Total Assets	2,653,626	2,527,587	1,195,170	1,145,484	3,848,796	3,673,071
<b>Liabilities</b>						
Long-term Liabilities Outstanding	608,392	568,936	163,570	168,710	771,962	737,646
Other Liabilities	96,890	83,381	38,738	30,150	135,628	113,531
Total Liabilities	705,282	652,317	202,308	198,860	907,590	851,177
<b>Net Assets</b>						
Invested in Capital Assets, Net of Related Debt	1,657,747	1,548,486	756,433	653,351	2,414,180	2,201,837
Restricted	72,795	199,767	23,472	20,842	96,267	220,609
Unrestricted	217,802	127,017	212,957	272,431	430,759	399,448
Total Net Assets	\$ 1,948,344	\$ 1,875,270	\$ 992,862	\$ 946,624	\$ 2,941,206	\$ 2,821,894

The largest portion of the City's net assets reflects its investment in capital assets (e.g. land, buildings, and equipment) of \$2.4 billion (82.1 percent) and \$2.2 billion (78.0 percent), less any related outstanding debt used to acquire those assets, for the fiscal years 2005 and 2004, respectively. Although the City's investment in its capital assets is reported net of related debt, the resources needed to repay this debt must be provided from other sources because the City uses these assets to provide services to citizens and; therefore, cannot liquidate them.

An additional portion of the City's net assets, \$96.3 million (3.3 percent) for fiscal year 2005 and \$220.6 million (7.8 percent) for fiscal year 2004 represent resources that are subject to external restrictions on how they may be used. The remaining balance of unrestricted net assets for fiscal years 2005 and 2004, \$430.8 million (14.6 percent) and \$399.4 million (14.2 percent), respectively, may be used to meet the government's ongoing obligations to citizens and creditors.

At the end of both the current and previous fiscal years, the City was able to report positive balances in all three categories of net assets, both for the government as a whole, as well as for the business-type activities.

## Analysis of Changes in Net Assets

The City's total net assets increased by \$119.3 million and \$179.3 million during the fiscal years 2005 and 2004, respectively. These increases are explained in the government and business-type activities discussion herein, and are primarily a result of contributions from developers of infrastructure assets.

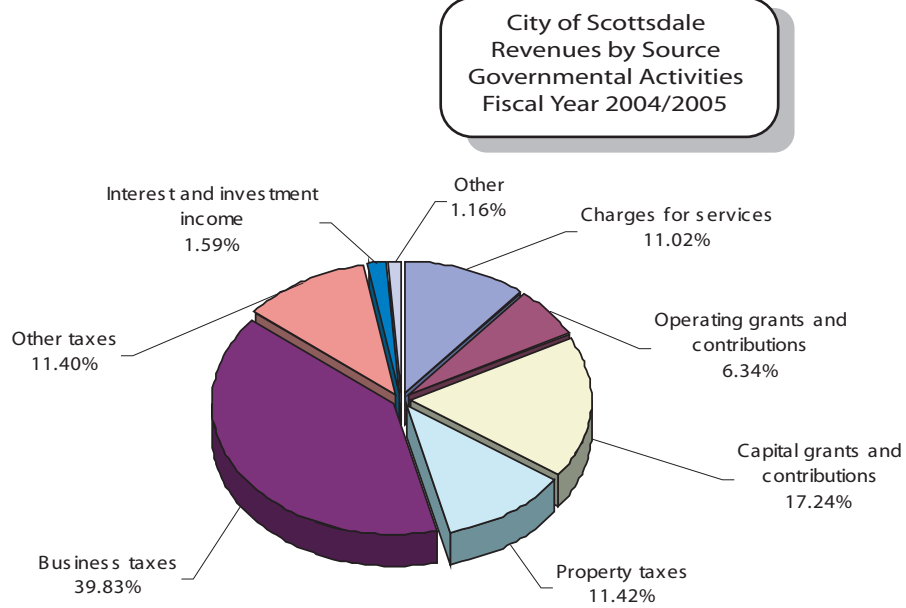
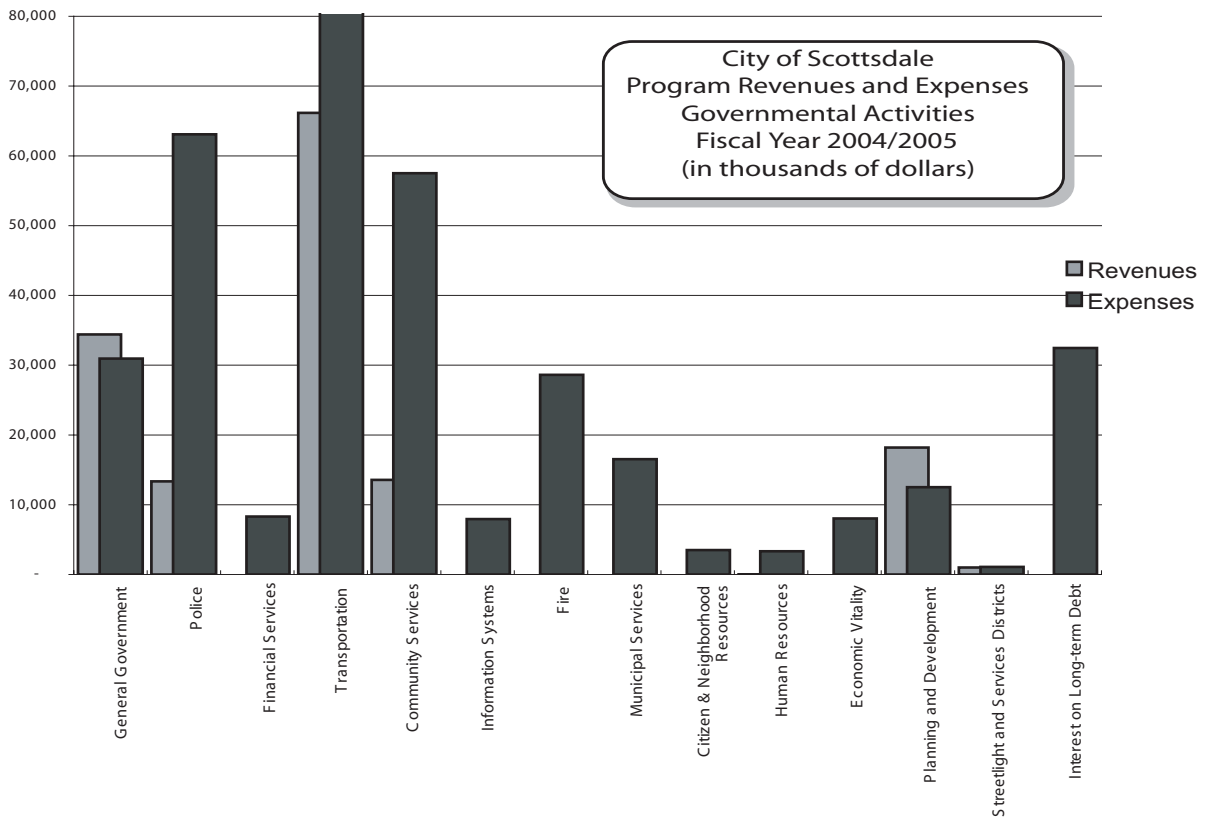
### Changes in Net Assets

For the Years Ended June 30, 2005 and 2004 (in thousands of dollars)

	Governmental Activities		Business-Type Activities		Total	
	2005	2004	2005	2004	2005	2004
<b>Revenues</b>						
Program Revenues						
Charges for Services	\$ 46,720	\$ 41,575	\$ 120,261	\$ 115,624	\$ 166,981	\$ 157,199
Operating Grants and Contributions	26,865	24,508	-	-	26,865	24,508
Capital Grants and Contributions	73,092	105,794	38,313	71,709	111,405	177,503
General Revenues						
Property Taxes	48,416	46,371	-	-	48,416	46,371
Business Taxes	168,909	136,668	-	-	168,909	136,668
Intergovernmental Taxes	48,346	45,163	-	-	48,346	45,163
Interest and Investment Income	6,765	2,655	4,288	973	11,053	3,628
Other	4,941	6,981	821	699	5,762	7,680
Total Revenues	424,054	409,715	163,683	189,005	587,737	598,720
<b>Expenses</b>						
General Government	30,943	23,839	-	-	30,943	23,839
Police	63,076	60,027	-	-	63,076	60,027
Financial Services	8,315	7,655	-	-	8,315	7,655
Transportation	85,835	78,373	-	-	85,835	78,373
Community Services	57,519	55,087	-	-	57,519	55,087
Information Systems	7,941	11,135	-	-	7,941	11,135
Fire	28,620	19,570	-	-	28,620	19,570
Municipal Services	16,520	13,024	-	-	16,520	13,024
Citizen and Neighborhood Resources	3,496	2,812	-	-	3,496	2,812
Human Resources	3,333	3,462	-	-	3,333	3,462
Economic Vitality	8,026	6,130	-	-	8,026	6,130
Planning and Development	12,522	11,697	-	-	12,522	11,697
Streetlight and Services Districts	1,094	1,024	-	-	1,094	1,024
Interest on Long-term Debt	32,466	28,028	-	-	32,466	28,028
Water Utility	-	-	59,723	51,095	59,723	51,095
Sewer Utility	-	-	28,324	24,678	28,324	24,678
Airport	-	-	3,346	2,622	3,346	2,622
Solid Waste	-	-	15,508	15,153	15,508	15,153
Total Expenses	359,706	321,863	106,901	93,548	466,607	415,411
Increase in Net Assets Before						
Special Items and Transfers	64,348	87,852	56,782	95,457	121,130	183,309
Gain/(Loss) on Sale of Capital Asset	(841)	(240)	(977)	206	(1,818)	(34)
Special Item - Defeasance of Debt	-	(3,964)	-	-	-	(3,964)
Transfers	9,567	11,037	(9,567)	(11,037)	-	-
Increase in Net Assets	73,074	94,685	46,238	84,626	119,312	179,311
Net Assets at Beginning of Year	1,875,270	1,780,585	946,624	861,998	2,821,894	2,642,583
Net Assets at End of Year	\$ 1,948,344	\$ 1,875,270	\$ 992,862	\$ 946,624	\$ 2,941,206	\$ 2,821,894

**Governmental activities.** Governmental activities increased the City's net assets by \$73.1 million in fiscal year 2005 and \$94.7 million in fiscal year 2004, thereby accounting for 61.3 percent and 52.8 percent, respectively, of the total growth in the net assets of the City. The key factor of this increase is as follows:

- For the second year in a row, City sales tax posted a year-over-year growth in the 2005 fiscal year resulting in an increase of 23.6 percent. Two new sales taxes were approved in May 2004 resulting in an additional 0.2 percent in Preserve Privilege Tax and 0.15 percent in Public Safety Tax. Although the property tax rates decreased in both fiscal years 2005 and 2004 property tax revenues rose 4.4 percent and 9.8 percent, respectively, over the previous years due to increases in assessed valuation.





As shown in the "Program Revenues and Expenses for Governmental Activities" chart and the "Revenues by Source for Governmental Activities" chart, transportation is the largest function in expense (23.9 percent), followed by police (17.5 percent), and community services (16.0 percent). General revenues such as property, business, and privilege taxes are not shown by program, but are effectively used to support program activities citywide. For governmental activities overall, without regard to program, business taxes, including Sales and Use Taxes and Franchise Taxes, are the largest single source of funds (39.8 percent), followed by capital grants and contributions (17.2 percent), and property taxes (11.4 percent).

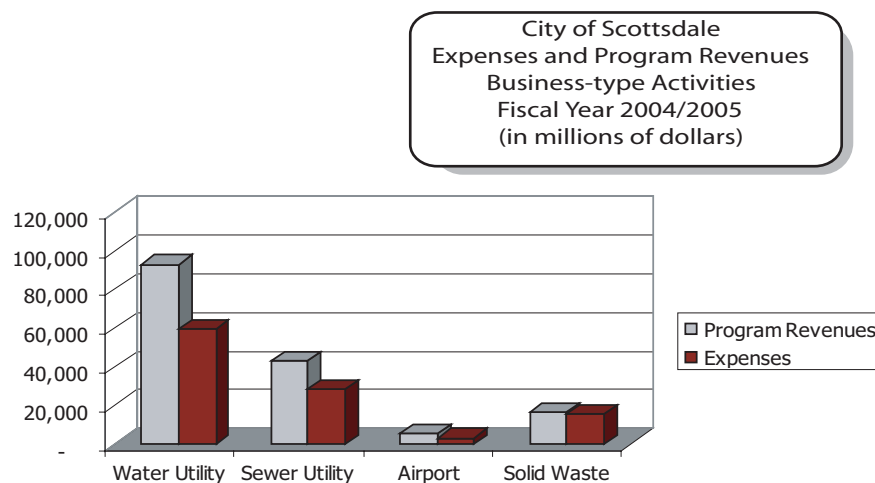
The Transportation department ensures that Scottsdale neighborhoods, businesses and visitors are provided an accessible, environmentally sensitive, safe and efficient transportation system. Projects and operations for street, transit and non-motorized travel are developed in cooperation with the public and promote economic sustainability for the community, preserves and enhances neighborhood quality of life and ensures seamless connections to the regional network.

The Scottsdale Police Department, in partnership with the citizens of Scottsdale, recognizes the changing needs of our community and law enforcement's role in addressing those needs. Furthermore, they pledge excellence, initiative and integrity to enhance the quality of life throughout our City knowing those they serve deserve no less.

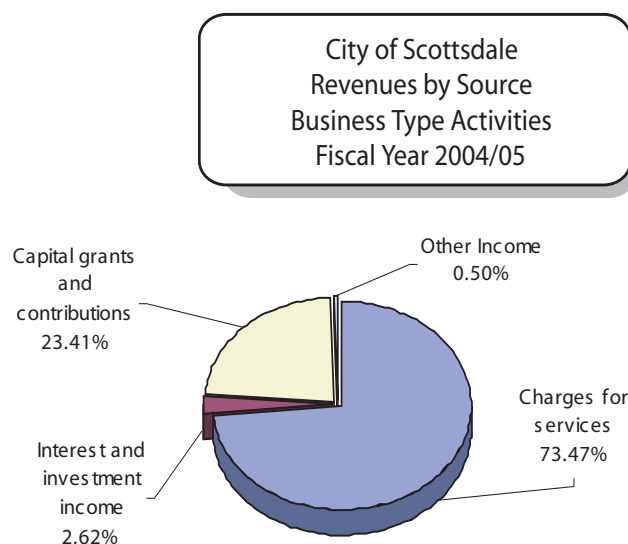
The City's Community Services Department improves and preserves Scottsdale's quality of life through development of safe and highly maintained facilities and imaginative services that provide opportunities for family interaction, cultural enrichment, and development of lifetime skills which build self-esteem, promote healthy lifestyles and are a catalyst for community involvement. They provide assistance and guidance to those in need and link our citizens with information and resources throughout the world.

**Business-Type activities.** Business-type activities increased the City's net assets in fiscal years 2005 and 2004 by \$46.2 million and \$84.6 million, respectively, accounting for 38.7 percent and 47.2 percent, respectively, of the total growth in the City's net assets. The key factor of this increase is as follows:

- The Water and Sewer Utility Fund had capital contributions from developers and grantors resulting in \$35.9 million and \$70.9 million in revenue for fiscal years 2005 and 2004, respectively. The majority of this amount is from infrastructure donated from developers and development fees received as development continues throughout the City.







As shown in “Program Revenues and Expenses for Business Type Activities” and the “Revenues by Source for Business Type Activities” charts, the largest of Scottsdale’s business-type activities, Water and Sewer utilities, each had expenses of \$59.7 million and \$28.3 million, respectively, in fiscal year 2005, followed by Solid Waste with operating expenses of \$15.5 million. For the fiscal year, revenues exceeded expenses in all four areas of business activity. Revenues exceed expenditures due to multi-year financial planning and pay-as-you-go contributions to capital projects. Charges for services provided the largest share of revenues (73.5 percent) followed by capital grants and contributions (23.4 percent), which are largely developer contributions and development fees, for all of the business-type activities.

The City’s Water Resources Department plans, manages and operates a safe, reliable water supply and wastewater reclamation system and provides efficient, high quality customer service to Scottsdale citizens.

The Solid Waste Department provides effective and responsive leadership that ensures the delivery of safe, efficient and environmentally sound solid waste services to approximately 73,000 residential customers and 1,400 commercial and roll-off customers.

## **FINANCIAL ANALYSIS OF THE CITY’S FUNDS**

As noted earlier, the City uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

### **Governmental Funds**

Funds are created and segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations. An activity not required to be reported in a separate fund is included in the general fund. Governmental funds are used to account for tax-supported activities.

The focus of the City’s governmental funds is to provide information on near-term inflows, outflows, and balances of resources that are available for spending. Such information is useful in assessing the City’s financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government’s net resources available for spending at the end of the fiscal year. These funds are accounted for by using the modified accrual basis of accounting. Types of governmental funds reported by the City include the General Fund, Special Revenue Funds, Debt Service Funds, and Capital Project Funds.

As of the end of the current fiscal year, the City's governmental funds reported combined ending fund balances of \$264.8 million, a decrease of \$52.7 million in comparison to the combined ending fund balances for fiscal year 2004 of \$317.5 million. The decrease in the current year's fund balance is primarily due to land purchases during fiscal year 2005. Approximately \$253.3 million of the total for fiscal year 2005 and \$306.3 million of the total for fiscal year 2004 constitutes unreserved fund balance, which is available for spending at the City's discretion. The remainder of fund balance is reserved to indicate that it is not available for new spending because it has already been committed, (1) to pay debt service (\$10.6 million and \$9.1 million for fiscal years 2005 and 2004, respectively); (2) for the repayment of a long-term loan from another fund (all amounts were repaid in 2005, but \$1.3 million was reserved for this purpose in fiscal year 2004) or; (3) to pay for the ongoing cost of the streetlight and services districts (\$872,000 and \$891,000 for fiscal years 2005 and 2004, respectively).

Revenues for governmental functions overall totaled approximately \$363.0 million in fiscal year 2005, an increase of 18.2 percent (\$55.9 million) over the previous year total of \$307.1 million. In fiscal year 2005 expenditures for governmental functions, totaled \$494.2 million, an increase of 46.3 percent (\$156.5 million) over the fiscal year 2004 total of \$337.7 million. In the fiscal years ended June 30, 2005 and 2004 expenditures for governmental functions exceeded revenues by approximately \$131.2 million (36.1 percent) and \$30.6 million (10.0 percent), respectively. The excess in both years was due to the City financing some capital projects with debt proceeds received in prior years and reflected in beginning fund balance. Increases in the excess from 2004 to 2005 were mainly due to land purchases by the City in fiscal year 2005.

The General Fund is the chief operating fund of the City. At the end of the current fiscal year, the unreserved fund balance of the General Fund was \$72.8 million, while total fund balance was \$73.6 million. The unreserved and total balances for the General Fund at the end of fiscal year 2004 were \$59.7 million and \$61.9 million, respectively. As a measure of the General Fund's liquidity, it may be useful to compare both unreserved fund balance and total fund balance to total fund expenditures. Unreserved fund balance represents 38.6 percent of the total General Fund expenditures of \$188.4 million in fiscal year 2005 and 34.3 percent of the total General Fund expenditures of \$174.2 million in fiscal year 2004. The total fund balance represents 39.1 percent and 35.5 percent of total fund expenditures for fiscal years 2005 and 2004, respectively. In fiscal year 2005 management has designated \$29.9 million of the General Fund unreserved fund balance for various uses. See note section III.D in the Notes to the Financial Statements for further information regarding reservations and designations.

For the first time in three years the fund balance in the City's General Fund increased. The increase in fiscal year 2005 by \$11.8 million is mainly due to a brighter economic outlook and rising consumer confidence that resulted in increased sales tax revenues for the City. Overall, the General Fund's performance resulted in revenues over expenditures in the fiscal year ended June 30, 2005, of \$49.1 million, an increase of 44.1 percent over the comparable figure from the prior year of \$34.1 million.

The General Obligation Bond Debt Service fund is used to account for the accumulation of resources for, and the payment of, general obligation long-term debt principal, interest and related costs. At the end of the current fiscal year, the fund balance of the General Obligation Bond Debt Service Fund was \$5.6 million, an increase of \$2.1 million from the \$3.5 million at the end of fiscal year 2004.

The General CIP Construction Capital Project fund accounts for the resources used to acquire, construct and improve major capital facilities, other than those financed by Proprietary Funds. At the end of the current fiscal year, the fund balance of the General CIP Construction Capital Project Fund was \$113.6 million, compared to a fund balance of \$88.9 million at the end of fiscal year 2004. The increase in fund balance is primarily due to amounts transferred from the General Fund to fund the pay-as-you-go Capital Improvement Plan and debt proceeds. Capital improvement expenditures in 2005 and 2004 were \$115.6 million and \$25.0 million, respectively, an increase of \$90.6 million, which is explained in greater detail in the Capital Assets section of this report.

The Preserve Privilege Tax Fund accounts for the resources used to acquire and improve land within the McDowell Sonoran Preserve. Resources are provided by the proceeds from the sale of bonds and the .15 percent Preserve Privilege Tax approved in May of 2004. In fiscal year 2005 the City acquired an additional 677 acres of land, totaling \$60.8 million, for inclusion in the McDowell Sonoran Preserve.

### **Proprietary Funds**

The City's Proprietary Funds provide the same type of information found in the government-wide financial statements, but in more detail.

At the end of the fiscal years 2005 and 2004, the unrestricted net assets for the Water and Sewer Utility were \$204.3 million and \$265.4 million, respectively; Scottsdale Airport were \$2.1 million and \$1.2 million, respectively; and the Solid Waste Utility Fund were \$6.6 million and \$5.8 million, respectively. The Internal Service Funds, which are used to account for certain governmental activities, also had unrestricted net assets of \$16.6 million and \$15.6 million, respectively.

The total growth in net assets for the Enterprise Funds was \$46.2 million and \$84.6 million for fiscal years 2005 and 2004, respectively. Factors concerning the finances of these funds have been addressed previously in the discussion of the City's business-type activities. In particular, the Scottsdale Water and Sewer net assets increased by \$43.8 million due to capital contributions of \$35.9 million as well as increased revenues.

### **Fiduciary Funds**

The City maintains Fiduciary Funds for the assets of the Family Self-Sufficiency Agency Fund, the Retainage Escrow Agency Fund, the Handicap Scholarship Private Purpose Trust Fund, and the Scottsdale Memorial Hospital Redevelopment Private Purpose Trust Fund. The Hospital Trust Fund manages the investment of monies held in trust for the redevelopment of the Scottsdale Memorial Hospital. As of the end of fiscal year 2005, the net assets of the Scottsdale Memorial Hospital Trust Fund totaled \$19,000, representing a decrease of \$345,000 in total net assets since June 30, 2004. The change is primarily related to increased expenses and completion of projects directly related to the redevelopment area. Changes to the other Fiduciary Funds were immaterial for the fiscal year.

## General Fund Budgetary Highlights

The City adopts an annual appropriated budget for its General Fund. A budgetary comparison statement has been provided for the General Fund to demonstrate compliance with this budget.

The City's final budget differs from the original budget due to adjustments that were made during the fiscal year. In fiscal year 2005, there was a slight increase in expenditure budgets; however, the City maintained an excess of revenues over expenditures and did not exceed the total appropriations for the year. The majority of these changes were contingency transactions approved by the City Council and budgetary transfers to the Fleet Management Fund for vehicle adjustments. Net budget increases for expenditures by department totaled \$190,000 and \$434,000 for fiscal years 2005 and 2004, respectively. The net increase is defined as follows:

\$ 183,000	General Government
(800,000)	Police
(50,000)	Community Services
(31,000)	Information Systems
257,000	Fire
(53,000)	Citizen & Neighborhood Resources
(61,000)	Human Resources
745,000	Economic Vitality

During the year, actual revenues and other resources exceeded budgetary estimates by \$26.7 million compared to \$18.9 million in fiscal year 2004.

## Capital Assets and Debt Administration

### Capital Assets

The City's capital assets for its governmental and business-type activities as of June 30, 2005 and 2004, amount to \$3.2 billion and \$2.9 billion, respectively (net of accumulated depreciation). Capital assets include land, buildings and improvements, water and sewer systems, water rights, vehicles, machinery and equipment, furniture and fixtures, and construction in progress. The total increase in the City's capital assets (net of accumulated depreciation) for the fiscal years 2005 and 2004 was 8.2 percent as shown in the table below.

#### Capital Assets, Net of Depreciation

For the Years Ended June 30, 2005 and 2004 (in thousands of dollars)

	Governmental Activities		Business-Type Activities		Total	
	2005	2004	2005	2004	2005	2004
Land	\$ 514,588	\$ 413,520	\$ 24,065	\$ 24,162	\$ 538,653	\$ 437,682
Buildings and Land Improvements	136,185	135,751	10,146	10,757	146,331	146,508
Streets and Storm Drains	1,417,799	1,433,989	-	-	1,417,799	1,433,989
Machinery and Equipment	20,173	17,807	3,972	3,388	24,145	21,195
Water Rights	-	-	64,688	64,688	64,688	64,688
Water System	-	-	401,207	406,412	401,207	406,412
Sewer System	-	-	257,445	258,737	257,445	258,737
Motor Vehicles and Maintenance by Fleet	22,629	23,450	-	-	22,629	23,450
Furniture, Fixtures and Office Equipment	-	-	117	178	117	178
Construction in Progress	126,451	66,165	151,002	52,208	277,453	118,373
Total	\$ 2,237,825	\$ 2,090,682	\$ 912,642	\$ 820,530	\$ 3,150,467	\$ 2,911,212

Major capital asset events during the current fiscal year included the following:

- Construction in progress on the Chaparral Water Treatment Plant – A multiple construction contract project accounting for total budgeted funds of approximately \$83 million with total expenditures for the current fiscal year of \$34 million.
- The City's water and sewer 5-year capital improvement plan includes significant cost impacts from "unfunded" federal water quality mandates for treatment of arsenic and disinfection by-product requirements, in addition to plant and infrastructure expansion to accommodate growth. The most significant CIP cash expenditures, in addition to the Chaparral Water Treatment Plant noted above, forecasted in the 5-year plan include: Arsenic Mitigation Treatment (\$21 million), the CAP Water Connection from Shea to McDonald (\$9 million), the 91st Avenue Wastewater Treatment Plant expansion and improvements (\$15 million), and the Water Reclamation Plant Phase 3 Expansion (\$10 million).
- The acquisition of an additional 677 acres of land, totaling \$60.8 million, for inclusion in the McDowell Sonoran Preserve.
- Construction continued on Scottsdale Road from Indian Bend to Gold Dust Road totaling \$7.1 million in expenditures this year.
- Costs associated with the City's acquisition of a new fire department included expenditures related to enhanced fire service communications and transition costs in the amount of \$3.2 million and \$5.3 million, respectively.
- The acquisition of a building for the new police/fire headquarters for \$7.7 million.
- The City purchased a 42 acre parcel of property, known as Los Arcos, at a cost of \$41.8 million for the development of the ASU Scottsdale Center for New Technology and Innovation.

For government-wide financial statement presentation, all depreciable capital assets were depreciated from acquisition date to the end of the current fiscal year. Fund financial statements record capital asset purchases as expenditures. See Section IV in the Notes to the Financial Statements for further information regarding capital assets.

## Debt Administration

At the end of the fiscal years 2005 and 2004, the City had total long-term obligations outstanding of \$766.6 million and \$737.6 million, respectively. Of these amounts, \$378.6 million and \$400.2 million, respectively, are General Obligation Bonds backed by the full faith and credit of the City. The remainder includes revenue bonds, certificates of participation, and other obligations of \$388.0 million and \$337.4 million, respectively.

### Outstanding Debt

For the Years Ended June 30, 2005 and 2004 (in thousands of dollars)

	Governmental		Business-Type		Total	
	Activities		Activities			
	2005	2004	2005	2004	2005	2004
General Obligation Bonds	\$ 372,070	\$ 389,598	\$ 6,515	\$ 10,651	\$ 378,585	\$ 400,249
Revenue Bonds	5,815	8,475	65,735	68,365	71,550	76,840
Municipal Property Corporation Bonds	61,253	4,850	79,430	83,365	140,683	88,215
Scottsdale Preserve Authority Bonds	83,385	85,980	-	-	83,385	85,980
Special Assessments Bonds	6,340	8,755	-	-	6,340	8,755
Certificates of Participation	7,650	-	-	-	7,650	-
Community Facilities Districts General						
Obligation Bonds	43,480	44,950	-	-	43,480	44,950
Add Deferred Issuance Premiums	11,868	8,741	6,059	6,617	17,927	15,358
Less Deferred Amounts on Refunding	(11,693)	(9,153)	(1,530)	(1,819)	(13,223)	(10,972)
Total Bonds Payable	580,168	542,196	156,209	167,179	736,377	709,375
Contracts Payable	14,324	13,702	-	-	14,324	13,702
Capital Lease	-	-	-	-	-	-
Compensated Absences	13,900	13,038	1,971	1,531	15,871	14,569
Total Long-Term Liabilities	<u>\$ 608,392</u>	<u>\$ 568,936</u>	<u>\$ 158,180</u>	<u>\$ 168,710</u>	<u>\$ 766,572</u>	<u>\$ 737,646</u>

During fiscal years 2005 and 2004, the City's total bonded debt increased by approximately \$27.0 million and \$111.6 million, respectively. Although the City reduced several bond payable balances, the key contributors to the increase were the issuance of new Municipal Property Corporation bonds in the amount of \$60.7 million and Certificates of Participation in the amount of \$7.7 million during fiscal year 2005.

The State constitution imposes certain debt limitations on the City of six percent (6%) and twenty percent (20%) of the outstanding assessed valuation of the City. The City's available debt margin at June 30, 2005 and 2004 is \$195.8 million and \$163.5 million, respectively, in the 6% capacity and \$554.9 million and \$475.3 million, respectively, in the 20% capacity. Additional information on the debt limitations and capacities may be found in Section IV of the Notes to the financial statements and also in Table XIVa in the statistical section of this report.

The City's ratings on uninsured General Obligation Bonds as provided above were affirmed by the Rating Agencies in February 2005 in conjunction with the issuance of General Obligation Refunding Bonds. Rating Agencies also reviewed and confirmed several of the revenue based bond ratings at various times throughout the year with the latest ratings shown in the schedule below.

Additional information in the City's long-term debt can be found in Section IV of the Notes to the Financial Statements.

**City of Scottsdale Bonded Debt Ratings**  
**As of June 30, 2005**

	Moody's Investors Service	Standard and Poor's Rating Group	Fitch Investors Service, Inc.
General Obligation (GO)	Aaa	AAA	AAA
Municipal Property Corp (MPC)	Aa1	AA+	AA+
Water and Sewer Revenue (W&S)	Aa1	AA+	AA+
Highway User Revenue Fund (HURF)	Aa3	AA	Not Rated
Scottsdale Preserve Authority (SPA)	Aa3	AA-	AA-

### **Economic Factors and Next Year's Budget and Rates**

The City of Scottsdale's fiscal year 2006 budget reflects continuing strength in the City's economy, reinforced by positive trends at the state and national levels. Modest improvements projected in the City's revenues, combined with savings carried over from fiscal year 2005, will allow Scottsdale to balance its budget, meet its most pressing needs and fund the City's highest priorities for fiscal year 2006. These needs include a new municipal fire department, additional police officers, added operating costs related to the opening of new City facilities, a continued focus on code enforcement and property maintenance in the mature portions of the City, and continued emphasis on economic vitality and revitalization.

With improved economic conditions, the City has an opportunity to address programs not funded in recent budgets. At the same time, the long-range financial outlook requires conservative focus only on the highest Council and citizen priorities. All areas of the City have pent-up demands and it is not possible to address them all.

The revenue forecasts used in the budget are cautiously optimistic. There is no assumption that the City has returned to the extraordinary economic conditions of the 1990s. The City is past its historic period of peak expansion and the long-term budget plans must recognize that fact.

In addition to the factors mentioned above, all of the following factors were considered in preparing the City's budget for fiscal year 2006:

The City continued to use a zero based, "program budget" approach, which focuses on the quality of each service citizens receive from the City, whether the service is provided by one department or several. The staff also continued to develop a more realistic and precise plan for continued investment in the City's basic infrastructure and public facilities, combined with a more comprehensive analysis of maintenance and operating costs.

Under the adopted budget, General Fund expenditures, debt payments and transfers-out to other funds increase from \$228.5 million in the current fiscal year to \$255.9 million. The largest single factor in the increase is the addition of approximately 119 full-time equivalent positions, most of which are for front line employees who will provide direct services to citizens or provide basic support services for the staff serving the public. Included in the new full time equivalent positions are the following types of staff:

- **Staffing for new or expanded City facilities**, mainly funded by voter-approved bonds, which are scheduled to open in the coming year. These include a new sports complex, senior center and aquatics center.
- **Public safety positions, a significant number of them funded through the voter-approved public safety tax.** These include increases in the number of patrol officers and other personnel to improve police services.



- **Staff needed to continue the City's emphasis on revitalization.** These positions include downtown maintenance workers and code enforcement inspectors.
- **Sufficient staff to meet customer service needs** in such areas as after-school programs for youth, processing of utility payments and compliance with Americans with Disabilities Act requirements.
- **Staff to meet "internal" service demands.** These are positions in the legal, financial and information systems areas that support the day-to-day needs of other operating departments.

A separate, key component of the annual financial plan is the City's five-year Capital Improvement Plan (CIP) for infrastructure and public facilities including roads, water and sewer improvements, parks, buildings and information technology. The adopted CIP appropriation for fiscal year 2006 is \$899.7 million, which includes \$415.8 million (or 46.2 percent of the total) re-budgeted from the prior year. Under Arizona law, the City must re-budget for a capital project until it is completed. Some examples of major projects included in the CIP budget are:

- **Community Facilities** – Improvements to the Civic Center Library, renovation of the Scottsdale Center for the Performing Arts, expansion of the spring training facilities, additional ball fields for Vista Del Camino and the construction of a multi-purpose building at WestWorld.
- **Preservation** – Construction of trails supporting the gateway to the preserve and expansion of preserve lands.
- **Drainage and Flood Control** – Drainage improvement to several areas within Scottsdale including the TPC, Indian School Road, Pima Road, North Scottsdale Road and the Upper Camelback Wash.
- **Public Safety** – The addition of a fire station for the South Quadrant and expansion of Fire Station #604, as well as construction to the District 1 Police Facilities.
- **Service Facilities** – The addition of new parking garages on North Marshall Way and the South Canal Bank, as well as maintenance to community service facilities.
- **Transportation** – Improvements to several main Scottsdale thorough ways including Indian Bend Road, Indian School Road, Scottsdale Road, Thompson Peak Parkway and Hayden Road. Additionally, enhancements to bicycle lanes and pedestrian paths will be made on Thomas and McDowell Roads. There will also be improvements made to bus stops around the City and a transit passenger facility will be added to the ASU Scottsdale Center.
- **Water Services** – Expansion and regulatory compliance to the CAP Plant, as well as the addition of arsenic mitigation facilities for the City's water system.

The adopted budget includes funding for the City's new municipal Fire Department which began operations in July 2005. The total Fire Department budget is \$26.6 million and includes 257 positions approved by City Council on September 7, 2004. The positions were added in fiscal year 2005 to accommodate required firefighter training prior to their July 2005 start date. In fiscal year 2005 the City Council also approved Fire Department enhancements beyond the current service levels, such as staffing levels (adding a 4<sup>th</sup> firefighter on a truck) and work hours (56 hour work week). The enhancements are reflected in the adopted budget.

The adopted budget continues the practice of setting aside a reserve equal to 10 percent of the General Fund and Highway User Fund program budgets to ensure the City can provide basic services in the event of major emergencies.

### **Requests for Information**

This financial report is designed to provide a general overview of the City's finances for all of those with an interest in the government's finances. If you have questions about this report or need additional financial information, contact:

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Financial Services Department  
Accounting Division  
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Scottsdale, AZ 85251

(480) 312-2437

Or visit our website at:

<http://www.scottsdaleaz.gov/finance/>